

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #98-40**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Taking a credit on a current sales and use tax return for previous sales and use tax overpayments.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] of [CITY], Tennessee, is registered with the Department of Revenue for sales and use tax purposes and files sales and use tax returns. The taxpayer has overpaid use tax in previous periods which are within the statute of limitations period established under T.C.A. §67-1-1802(a). Additionally, the taxpayer has overpaid sales tax to certain vendors, also within the statute of limitations period.

QUESTIONS

1. Assuming that the taxpayer has made use tax overpayments in prior periods which fall within the applicable statute of limitations, can the taxpayer take a credit equal to these overpayments on its current sales and use tax return without filing a formal request with the Department of Revenue?
2. Assuming that the taxpayer has overpaid sales tax to certain vendors in prior periods which fall within the applicable statute of limitations, can the taxpayer take a credit equal to these overpayments on its current sales and use tax return without filing a formal request with the Department of Revenue?
3. In the event of an audit, if the taxpayer had previously been granted a refund or a credit for use tax overpayments, will such overpayments be reallocated into the audit period for the purpose of calculating the appropriate amount of penalty and interest?

RULINGS

1. No. Allowing a credit against tax liabilities is synonymous with granting a refund under T.C.A. §67-1-1802. Thus, no credit can be allowed for prior overpayments unless the requirements set out in T.C.A. §67-1-1802 are met, including approval by the appropriate official in the Department of Revenue and, in some cases, the Attorney General. Therefore, the taxpayer cannot take a credit for prior use tax overpayments without filing a formal request with the Department. This ruling does not apply to any specific provisions, such as T.C.A. §67-6-346, which allow taking a credit without filing a claim for refund.
2. No. Except in an audit situation, the taxpayer can only receive a refund or credit for sales tax overpayments from the vendor who collected the tax. After refunding the sales tax overpayment to the taxpayer, the vendor can file a claim for refund or credit with the Department. This ruling does not apply to any specific provisions, such as T.C.A. §67-6-346, which allow the purchaser to take a credit or receive a refund directly from the Department.

3. Yes. For the purpose of determining the proper amount of penalties and interest, previously credited or refunded use tax overpayments must be reallocated into the audit period and offset against any underpayments.

ANALYSIS

1. Title 67 of the Tennessee Code provides a remedy in cases where taxes are paid in error. T.C.A. §67-1-1802 provides in part as follows:

(a)(1) The commissioner of revenue, with the approval of the attorney general and reporter...is empowered and directed to refund to taxpayers all taxes collected or administered by the commissioner that are, on the date of payment, paid in error or paid against any statute, rule, regulation or clause of the constitution of this state or of the United States. Such refunds shall include, but not be limited to, credit carryovers generated after an audit review of returns, reports, or other documents filed by the taxpayer, including amendments thereto. Such refunds do not, however, include credits generated by mechanical processing or mechanical mathematical verification processes. The authority granted in this subdivision extends only to taxes for which a claim is filed, with the commissioner under oath and supported by proper proof, within three (3) years from December 31 of the year in which the payment was made. The entire disputed amount of tax, penalty and interest must be paid before any claim for refund thereof can be filed. Sales or use taxes which were collected from or passed on to customers by the taxpayer shall not be refunded unless the taxpayer has refunded or credited the sales or use tax to its customers.

(6)(A) The commissioner is authorized and empowered, in the commissioner's discretion, to designate subordinate officials in the department to approve, on the commissioner's behalf, claims for refunds in amounts of five thousand dollars (\$5,000) or less. Only one (1) such subordinate official and one (1) alternate subordinate official shall be designated to approve any one (1) class of claims. The commissioner shall notify, in writing, the commissioner of finance and administration and the attorney general and reporter as to the names of any such subordinate officials so designated.

(B) The commissioner is also authorized and empowered, in the commissioner's discretion, to approve claims for refunds in amounts of more than five thousand dollars (\$5,000) but not more than fifteen thousand dollars (\$15,000). The commissioner is authorized and empowered to designate, in the commissioner's discretion, subordinate officials in the department to initially review

claims for refund. Such subordinate official shall make a finding in regard to each claim recommending either approval or disapproval. This finding shall be reviewed by the legal office of the department of revenue, which shall make its own recommendation approving or disapproving the claim. Both these findings shall be submitted to the commissioner, or the commissioner's designated subordinate official, who shall make a final determination, either approving or disapproving the claim in the commissioner's or the commissioner's designated subordinate official's discretion based on all information available to the commissioner or the commissioner's designated subordinate official. The findings of the designated subordinate official and legal office shall be advisory only and shall not be construed to limit the discretion of the commissioner in making refunds under this subsection. The commissioner is authorized and empowered to designate subordinate officials in the department to approve on the commissioner's behalf claims for refund under this subdivision (a)(6)(B).

(C) The commissioner is also authorized and empowered to approve claims for refunds in amounts of more than fifteen thousand dollars (\$15,000); provided, that the attorney general and reporter may require that the refund of such claims or any class of such claims be subject to the attorney general and reporter's prior review and approval.

T.C.A. §67-1-1802(a)(1) and (6).

Allowing a credit for prior overpayments against current or future tax liabilities is synonymous with granting a refund under T.C.A. §67-1-1802. In the case of a refund, the taxpayer would tender the amount due for the current month and receive funds back for the prior overpayment. In the case of a credit, the taxpayer would simply tender the net amount. There is no relevant distinction between the two. Thus, no such credit can be allowed unless the requirements set out in T.C.A. §67-1-1802 are met. This conclusion is further supported by administrative rule. Sales and Use Tax Rule 1320-5-1-.79 states that “[n]o credit for overpayment of taxes may be given unless a person claiming credit would have a right to receive the credit by means of a Claim for Refund.” One of the requirements to receive a refund is the approval of the Commissioner or a duly appointed subordinate, and possibly the Attorney General, depending on the amount of the refund or credit. T.C.A. §67-1-1802(a)(6). Consequently, the taxpayer cannot take a credit for prior use tax overpayments without filing a formal request with the Department of Revenue.

It should be noted, however, that certain statutory provisions specifically allow credits without filing a claim for refund. See, e.g., T.C.A. §67-6-346 (allowing a purchaser to take credit for sales and use tax paid with respect to pollution

control). The facts provided here do not involve the application of any specific statutory credits, and this ruling does not address such provisions.

2. Sales and Use Tax Rule 1320-5-1-.79 prohibits the use of a credit to remedy the overpayment of taxes unless that taxpayer would be entitled to receive the credit by means of a Claim for Refund. As discussed below, the taxpayer cannot claim a refund from the state for sales tax erroneously paid to its vendors. *Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986); *Reimann v. Huddleston*, 883 S.W.2d 135, 136 (Tenn. Ct. App. 1993) *perm. app. denied* (1994). Therefore, the taxpayer cannot receive a credit from the Department as a result of sales tax overpayments. The only exception to this rule is a situation in which the taxpayer is under audit, which is not the situation set out in this question. See T.C.A. §67-6-516.

Every dealer making sales of tangible personal property or furnishing taxable services is liable for the tax imposed. T.C.A. §67-6-501. The dealer is directed to collect the tax from the consumer insofar as it can be done. T.C.A. §67-6-502. Thus, the legal incidence of the sales tax is clearly placed upon the dealer, not the consumer. *Reimann*, 883 S.W.2d at 136. When the taxpayer made purchases from its vendors, the vendors became liable for the tax and paid it to the Department. Consequently, the vendor, not the taxpayer, is the proper party to seek a refund from the Department for any overpayments. *Id.* It is not enough to show that the economic burden of the tax was passed on to the taxpayer. *Id.* The taxpayer's proper remedy lies against the vendor who collected the tax. *Id.* at 137. Once the vendor has refunded the excess sales tax to the taxpayer, the vendor will be entitled to file a claim for refund with the Department. T.C.A. §67-1-1802(a)(1). Because the taxpayer cannot claim a refund with respect to sales tax paid to its vendors, it also cannot claim a credit for such taxes. TENN. COMP. R. & REGS. 1320-5-1-.79.

As noted in the preceding section, certain statutory provisions specifically allow credits without filing a claim for refund. See, e.g., T.C.A. §67-6-346 (allowing a purchaser to take credit or receive a refund for sales and use tax paid with respect to pollution control). The facts provided here do not involve the application of any specific statutory credits, and this ruling does not address such provisions.

3. In the event of a sales and use tax audit, the applicable statute provides that the earliest underpayments must be offset against the earliest overpayments for the purpose of calculating the proper amount of interest and penalty:

When an examination of a dealer's books and records indicates that the dealer is deficient in paying the proper tax due for a month, but has paid more tax than is actually due for another month, or is deficient in paying the proper tax on one (1) or more transactions within a month, but has paid more tax than is actually due on other

transactions during the same month, or has erroneously paid tax to another dealer, the overpayment or erroneous payment shall be applied to the deficiency before computing any interest and penalty due as a result of such examination, the earliest overpayments offsetting the earliest underpayments for this purpose, and the penalty, if any, being computed on the amounts of underpayments not offset by overpayments.

T.C.A. §67-6-516. Consequently, penalties and interest will accrue only on the net amount of the taxpayer's underpayment.

This result should not change when the taxpayer has received a refund or credit prior to the audit. Therefore, the same procedure will be followed when the overpayments have been credited or refunded to the taxpayer between the time in which they accrued and when the audit takes place. The overpayments will be reallocated into the audit period and offset against any underpayments as described in T.C.A. §67-6-516.

David A. Gerregano, Tax Counsel

APPROVED:

Ruth E. Johnson, Commissioner

DATE: 9-11-98